In the Supreme Court of the United States

OCTOBER TERM, 1968

No. 1134

GEORGE T. WILLIAMS and MARCIA J. WILLIAMS,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The per curiam order of the court of appeals (Pet. 16) is not yet officially reported. The decision of the Tax Court (Pet. 9-15) is reported at 47 T.C. 689.

JURISDICTION

The order of the court of appeals was entered on October 21, 1968 (Pet. 16). The time for filing the petition for certiorari was extended to and including

March 10, 1969, by order of Mr. Justice Stewart on January 22, 1969. The petition for writ of certiorari was filed on March 10, 1969. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTE INVOLVED

The relevant portion of Internal Revenue Code of 1954, Section 163(a) is:

> § 163. Interest. (a) General Rule—There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness.
>
> * * * *
>
> [26 U.S.C. 163(a).]

QUESTION PRESENTED

Whether any parts of payments made to reinstate a lapsed insurance policy may properly be treated as deductible interest under Section 163(a) of the Internal Revenue Code of 1954.

STATEMENT

While serving in the United States Army, petitioner acquired a $10,000 National Service Life Insurance policy from the Government. He subsequently converted that policy into a Twenty Payment Life Plan policy (hereinafter referred to as the "policy") effective as of February 1, 1949. (Pet. 10.)

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[1] The issue in this case relates to transactions of George T. Williams. His wife, Marcia, is a party solely because joint returns were filed for the years in question. All references will be to George T. Williams as the petitioner.

The policy contained the following relevant provisions (Pet. 11-12):

2. REINSTATEMENT

If this policy has lapsed but has not been surrendered for its net cash value, it may be reinstated at any time provided the following requirements are met:

(a) A written application signed by the Insured, and evidence of health satisfactory to the Administrator must be furnished if required.

(b) Premiums for all monies in arrears must be paid, with interest from their respective due dates at a rate to be determined by the Administrator.

(c) Any indebtedness on this policy at the time of lapse must be repaid or reinstated, together with policy loan interest thereon. Any excess of the indebtedness and interest over the reserve of this policy at the time of reinstatement must be paid.

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7. EXTENDED TERM INSURANCE

If this policy lapses after being in force at least 3 months, it will be automatically extended as term insurance. The amount of the extended term insurance will be the face amount of this policy less any indebtedness. The term of such insurance will run from the date of lapse for as long as the reserve at that time plus any dividend accumulations less any indebtedness will purchase when applied as a net single premium at the Insured's attained age. * * *

8. Policy Loans

> Provided this policy is not lapsed, the Insured may obtain a loan on the security of this policy at any time after the end of the first policy year.
> * * *
> The loan will bear interest at a rate to be determined by the Administrator. Any interest not paid when due will be added to the existing loan and bear interest at the same rate. If at any time the indebtedness equals or exceeds the reserve plus any dividend accumulations, this policy will cease and become void. The indebtedness on this policy at any time includes accrued interest.

Petitioner paid the monthly premiums of $20.80 from the effective conversion date of February 1, 1949, through June 1, 1951. On March 15, 1951, he obtained a loan on the security of the policy in the amount of $333. On July 1, 1951, the policy lapsed for nonpayment of premiums, but, pursuant to the policy provisions, continued in effect as extended term insurance until October 4, 1952. (Pet. 12.)

In 1961, petitioner applied to have the policy reinstated in accord with the "Reinstatement" provisions. Effective October 10, 1961, the policy was reinstated at the 1949 premium rate, after submission of evidence of satisfactory health. For the reinstatement, petitioner paid cash in the amount of $459.54, and assumed a loan liability of $2,582.87 to the company. In determining the amount necessary to reinstate the policy, the insurer credited the sum of (1) the loan value of the policy as of October 31, 1961 ($2,584) and (2) the "accumulated" dividends ($636.90) against the sum of (1) the premiums that had not

been paid between July 1, 1951, and October 31, 1961 ($2,579.20), (2) four per cent per annum "interest" thereon ($595.90), (3) the 1951 loan ($333), and (4) four per cent per annum "interest" thereon ($172.34). (See Pet. 13.)

In his 1961 return petitioner claimed an "interest" deduction of $768.24, which was the sum of the $595.90 denominated as "interest" on past unpaid premiums and the $172.34 denominated as "interest" on the 1951 loan. (Pet. 13.) The Commissioner of Internal Revenue disallowed the claimed deduction on the ground that none of the $768.24 constituted interest paid on "indebtedness" within the purview of Section 163(a) of the Internal Revenue Code of 1954. The Tax Court upheld the Commissioner's determination (Pet. 14-15) and the court of appeals affirmed (Pet. 16).

ARGUMENT

The decision of the court of appeals is correct and there is no conflict or other reason warranting review by this Court.

1. Section 163(a) of the Internal Revenue Code of 1954 allows an individual to deduct "interest paid or accrued within the taxable year on indebtedness." By this section, Congress intended, and the Courts have held without exception, that interest to be deductible must be paid on an unconditional and legally enforceable obligation. *Autenreith* v. *Commissioner*, 115 F. 2d 856 (C.A. 3); *Gilman* v. *Commissioner*, 53 F. 2d 47 (C.A. 8). The controlling fact here, as found by the Tax Court (Pet. 14-15), is that, during the years

in which the policy was in lapsed status, the taxpayer held no money belonging to the insurance company and owed it no legally enforceable debt. The amounts designated as "interest" by the company in computing the amount required from petitioner as a condition of reinstatement of the policy [2] were merely a computational device by which the company realized the equivalent of the unpaid premiums plus the earnings that would have been realized had they been timely paid.

2. *Journal Co.* v. *Commissioner*, 125 F. 2d 349 (C.A. 7), upon which taxpayer relies (Pet. 2, 6), is not in conflict with the present decision. There the Court found that a binding contract had existed as of the date of its execution, although it remained executory until judicial approval was obtained. While the agreement gave the seller the right to the contract price as of the contract date and to interest between that date and the date of actual payment, the taxpayer-buyer could not, after the contract was executed, by his own volition decline to pay the principal amount to the seller. Here, in contrast, petitioner was under no obligation to pay the principal amount up to the moment he decided to do so. Therefore no indebtedness existed until the same moment.

Nor is there any conflict with *Deputy* v. *duPont*, 308 U.S. 488. There the taxpayer, in borrowing corporate stock, had promised to pay the lender, until the stock was returned in kind, an amount equal to all dividends paid on the stock plus any taxes result-

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[2] The character of the payments for tax purposes are not controlled by the designations given them by the parties. *Doyle* v. *Mitchell Brothers Co.*, 247 U.S. 179.

ing from the agreement. In rejecting the contention that these payments constituted deductible "interest * * * on indebtedness" under the then predecessor of Section 163(a),[3] the Court recognized that although the taxpayer was obliged to repay the stock, "an obligation is not necessarily an 'indebtedness' ". Here, petitioner had neither obligation nor indebtedness, since he had the option to determine for himself alone whether or not to pay the amounts he claims were his "debt".

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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[3] Section 23(b) of the Revenue Act of 1928, 45 Stat. 799.

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